

## TEACHERS' RETIREMENT BOARD

## INVESTMENT COMMITTEE

SUBJECT: Alternative Investments  
Activity Status Report

ITEM NUMBER: 13

ATTACHMENT(S): 3

ACTION: \_\_\_\_\_

DATE OF MEETING: February 2, 2000

INFORMATION: X

PRESENTER(S): Mr. Desrochers

The table below contains Alternative Investment activity for the month of December 1999 and historical information for selected time periods.

	Month Ended 12/31/99	Fiscal Year To Date	Past One Year	Past Three Years	Past Five Years
<u>Commitments:</u>					
Partnerships	\$ 0	\$ 710,000,000	\$ 1,357,625,000	\$ 3,375,577,413	\$ 4,449,378,409
Co-Investments	0	24,999,996	24,999,996	24,999,996	71,999,996
Secondaries	0	70,773,417	80,067,245	80,067,245	80,067,245
	<b>\$ 0</b>	<b>\$ 805,773,413</b>	<b>\$ 1,462,692,241</b>	<b>\$ 3,480,644,654</b>	<b>\$ 4,601,445,650</b>
<u>Contributions:</u>					
Partnerships	\$ 143,222,979	\$ 595,242,412	\$ 998,230,254	\$ 2,074,368,995	\$ 2,628,717,775
Co-Investments	0	24,999,996	24,999,996	24,999,996	71,999,996
Secondaries	180,000	57,872,402	65,634,231	65,634,231	65,984,231
Mgmt. Fee (Outside)	0	3,692,084	9,892,205	24,853,954	32,142,062
	<b>\$ 143,402,979</b>	<b>\$ 681,806,894</b>	<b>\$ 1,098,756,685</b>	<b>\$ 2,189,857,175</b>	<b>\$ 2,798,844,064</b>
<u>Distributions:</u>					
Cash	\$ 30,351,104	\$ 251,303,237	\$ 446,295,209	\$ 1,116,477,006	\$ 1,413,212,418
Stock	123,463,484	333,129,678	477,536,275	683,557,746	848,673,665
	<b>\$ 153,814,588</b>	<b>\$ 584,432,915</b>	<b>\$ 923,831,484</b>	<b>\$ 1,800,034,751</b>	<b>\$ 2,261,886,082</b>
Stock Sales	\$ 68,572,847	\$ 216,677,630	\$ 341,990,007	\$ 525,052,075	\$ 678,471,681

In accordance with the Alternative Investments Business Plan, this report also presents a summary of the status of the portfolio at the quarter ended December 31, 1999. Attachment 1 presents approved allocations and targets to each Alternative Investment Sub-Category, and shows CalSTRS' current exposure in each of the respective segments.

Attachment 2 contains a summary of investment performance and portfolio exposure by market segment. The venture capital segment, which represents 13.5% of the CalSTRS' portfolio, continues to outperform the other market segments.

An Executive Summary of Action Taken Under Delegation of Authority is included as Attachment 3. This represents an additional \$5 million commitment to J.H. Whitney IV. During the January Investment Committee Meeting, staff reported a \$95 million commitment, made under staff delegation of authority, to J.H. Whitney IV. However, at the partnership closing, one of the other limited partners unexpectedly withdrew their commitment to the fund. As a result, the Whitney General Partners offered CalSTRS the opportunity to increase its commitment by \$5 million. After this action, CalSTRS' commitment to J.H. Whitney IV totals \$100 million.

Alternative Investments  
Allocations and Targets  
As of December 31, 1999  
(\$000s)

**Allocation by Partnership**

Alt. Inv. Sub-Category	Market Value of Actual Partnership Strategies <sup>2</sup>	CalSTRS Market Value	12/31/99 Unfunded Commitments <sup>3</sup>	Market Value plus Unfunded Commitments (\$000s)	CalSTRS' Current Exposure	Long-Term Target Ranges	CalSTRS' Target
Buyouts <sup>1</sup>	\$ 1,994,608	61.1%	\$ 1,799,198	\$ 3,793,806	64.2%	50-70%	60%
Venture Capital	\$ 439,894	13.5%	\$ 300,337	\$ 740,231	12.5%	10-20%	16%
Debt Related	\$ 160,701	4.9%	\$ 80,522	\$ 241,223	4.1%	0-10%	2%
Equity Expansion	\$ 354,491	10.9%	\$ 166,190	\$ 520,681	8.8%	5-15%	7%
International	\$ 313,557	9.6%	\$ 303,590	\$ 617,147	10.4%	10-20%	15%
<b>Total</b>	<b>\$ 3,263,251</b>	<b>100.0%</b>	<b>\$ 2,649,837</b>	<b>\$ 5,913,088</b>	<b>100.0%</b>		<b>100%</b>

**Notes:**

<sup>1</sup> Market Value is based upon the actual strategy of the Partnership. Buyout sub-category includes Co-investment & Secondary MV's.

<sup>2</sup> Market Value Estimated as of 12/31/99 (using 9/30/99 actual market values adjusted for cash flows through 12/31/99).

<sup>3</sup> The following table includes all commitments made through 12/31/99.

**Alternative Investments**  
**Statement of Investments (Totals by Market Segment)**  
**For the Month Ending December 31, 1999**  
(in \$000's)

Partnership	\$ Weighted Age in Years	Age in Years	CalSTRS' Commit.		Cum. Contrib Dec-99	Cum. Distrib. Dec-99	Unfunded Dec-99	Est. Market Value Dec-99	Est. IRR 1 Dec-99	% of Portfolio	
Total Buyout:	1.8	4.4	\$ 3,588,317		\$ 1,804,216	\$ 987,551	\$ 1,784,100	\$ 1,807,578	26.6%	55.4%	<sup>3</sup>
Total Debt:	0.4	6.4	\$ 302,037		\$ 221,516	\$ 170,242	\$ 80,522	\$ 160,701	14.3%	4.9%	<sup>3</sup>
Total Equity Expansion:	1.0	5.3	\$ 640,000		\$ 473,810	\$ 700,641	\$ 166,190	\$ 354,491	21.3%	10.9%	<sup>3</sup>
Total International:	0.2	3.2	\$ 644,164		\$ 340,891	\$ 84,252	\$ 303,590	\$ 313,557	16.0%	9.6%	<sup>3</sup>
Total Venture Capital:	0.6	3.8	\$ 721,500		\$ 421,163	\$ 446,719	\$ 300,337	\$ 439,894	33.7%	13.5%	<sup>3</sup>
Total Co-Investment:	0.0	2.3	\$ 72,000		\$ 72,000	\$ -	\$ -	\$ 92,821	11.9%	2.8%	<sup>3</sup>
Total Secondary:	0.1	4.4	\$ 100,657		\$ 85,559	\$ 57,983	\$ 15,097	\$ 94,210	51.5%	2.9%	<sup>3</sup>
Total Portfolio:	4.5	4.5	\$ 6,068,675		\$ 3,419,155	\$ 2,447,388	\$ 2,649,837	\$ 3,263,251	23.9%	100.0%	<sup>3</sup>
Total Distributed Stocks Currently Held:								\$ 148,967			
Grand Total: Includes Total Portfolio and Total Distributed Stocks Currently Held:			\$ 6,068,675		\$ 3,419,155	\$ 2,447,388	\$ 2,649,837	\$ 3,412,217			

- Notes:
- <sup>1</sup> Estimated 12/31/99 IRR, using 9/30/99 actual market values adjusted for cash flows through 12/31/99.  
All internal rates of return (IRRs) are calculated using quarterly cash flows and are net of management fees and expenses.
- <sup>2</sup> Venture Economics Industry Benchmark - Median and Upper Quartile preliminary quarterly statistics as of September 30, 1999.  
For Venture Capital Funds: Used Venture Capital Returns  
For Buyout Funds: Used Buyout Returns  
For Debt Funds: Used Special Equity Returns  
For Equity Expansion Funds: Used All Private Equity Returns  
For International Funds: Used All Private Equity Returns
- CalSTRS % ownership is based upon the original commitment amount.
  - Distribution dates and amounts represent those reported by the partnerships, and in the case of stock distributions, do not represent the actual proceeds received by CalSTRS.
  - Contribution amounts reflect the impact of management fees charged by the partnerships.
- <sup>3</sup> % of Portfolio: Represents the Est. Market Value divided by the Total Market Value for the entire CalSTRS Portfolio.

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN  
UNDER DELEGATION OF AUTHORITY  
J. H. WHITNEY IV, L.P.

---

Action: Commit an additional \$5.0 million--for a total commitment of \$100 million--to J.H. Whitney IV, L.P. (JHW IV), which represents 10.5% of the total capitalization of the fund.

Background: J.H. Whitney & Co. was founded in 1946 by John Hay Whitney and functioned exclusively as a manager of Whitney family money throughout most of its history. The firm began investing with a small group of limited partners following Mr. Whitney's death in 1982, and created its first conventional equity limited partnership in 1990 (JHW I). Since 1990, Whitney partners have formed three private equity limited partnerships with total investments of approximately \$695 million in private equity capital. As of September 10, 1999, these investments have an estimated market value of \$1.2 billion, with over \$420 million in realizations.

CalSTRS is currently an investor in one J. H. Whitney partnership. CalSTRS committed \$17.3 million to JHW I in 1990.

Analysis: JHW IV qualifies as a follow-on fund as identified in the Alternative Investments policies.

JHW IV will invest in and provide assistance to companies in the growth capital niche (equity expansion). These growth-oriented companies typically have revenues of \$5 million to \$200 million and require an equity partner to reach the next stage of development. JHW IV will restrict its investments to companies operating in five complementary industry areas: communications, internet/technology, healthcare, transforming industries (mature industries that will benefit from the implementation of enhanced management techniques, new distribution

methodologies and new technology) and consumer business. The portfolio companies in which the partnership will invest will be located principally in the United States. The fund may invest up to 30% of capital commitments in international markets—these will be concentrated in Western Europe and to a lesser degree in the developed markets of Asia (primarily Japan). J.H. Whitney is noteworthy for its strong proprietary deal flow and the successful execution of a strategy that usually results in the firm being the first outside investor in a target company. This generally allows the firm to avoid competing with other providers of equity capital and thereby achieve enhanced returns on its investments.

- Investment Thesis:
- 1) The JHW IV fund is consistent with the approved target to invest 7% of the Alternative Investment portfolio in equity expansion partnerships.
  - 2) The J.H. Whitney Funds have consistently generated good investment returns. The returns of JHW II have exceeded the Venture Economics Upper quartile Benchmark, while the performance of JHW I has been midway between the Venture Economics median and the Upper Quartile Benchmark. (Because JHW III is so new (1998), it is too soon to be able to make a meaningful evaluation of the fund's returns.)
  - 3) The Principals are very experienced equity expansion specialists.
  - 4) The J. H. Whitney investment strategy provides a good fit in the CalSTRS portfolio. There are very few portfolio company holdings in common with CalSTRS' current partnerships.
  - 5) The General Partners are offering co-investment opportunities to CalSTRS with no fees and no carried interest.
  - 6) Staff has received a positive investment recommendation from Pathway Capital Management.

**Policy Compliance:** This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investment's advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner previously reviewed and approved by the Investment Committee.

**Recommendation:** Staff recommends that CalSTRS commit an additional \$5 million to J.H. Whitney IV, L.P. that became available at the time of the second closing, for a total commitment of \$100 million.

**By:**

\_\_\_\_\_  
Seth C. Hall  
Investment Officer

Date\_\_\_\_\_

**Approved:**

\_\_\_\_\_  
Réal Desrochers  
Director of Alternative Investments

Date\_\_\_\_\_

\_\_\_\_\_  
Patrick Mitchell  
Chief Investment Officer

Date\_\_\_\_\_

